PENNSYLVANIANS OPPOSE NEW SALES TAX ON BEER 7

TAXPAYER ADVOCATES HIT LIEBERMAN TAX HIKE 6

TAX WATCH 10-11

Budget & Tax News

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US and EU on Collision Course Over Taxes

The World Trade Organization ruled in November that U.S. tariffs on imported steel violate global trade rules. The European Union has threatened to impose $2.2 billion in sanctions against the U.S.

by John Skorburg

The World Trade Organization (WTO) ruled on November 10 that U.S. tariffs on imported steel, imposed in March 2002, violate global trade rules. The ruling, from the WTO's Appellate Body, authorizes the European Union (EU) and other complaining parties to impose retaliatory sanctions against the U.S. if the tariffs are not lifted. U.S. officials were given just 30 days to lift the tariffs.

The complaint was brought by Brazil, China, the European Communities, Japan, Korea, New Zealand, Norway, and Switzerland. The EU has threatened to impose $2.2 billion in sanctions against the U.S.; Japan and China issued similar threats.

The steel ruling comes just six months after the WTO's Dispute Settlement Body also ruled against the U.S., this time on a complaint over the Foreign Sales Corporation (FSC) mechanism used by U.S. corporations to protect rev-

WTO p. 4

Will States Tax the Internet?

by Christine Hall

Since November 1, all bets are off concerning the taxing of the Internet.

A five-year federal moratorium has prevented states and localities from levying taxes on Internet dial-up or broadband connections, but cash-hungry states are now looking for revenue, and retailers have little reason to help consumers skirt taxation.

While the House in September passed a bill to continue the ban, the Senate failed to act on its version of the measure (S. 150), authored by Senator George Allen (R-Virginia). As a result, new Internet taxes could go into effect between the time Congress adjourns and

INTERNET p. 17

Tobacco Tax Causes Chaos in NY State

by Diane Carol Bast

Every year, New York smokers avoid the state's punitive cigarette taxes by buying millions of dollars in tax-free cigarettes from Native American stores. Lawmakers now aim to tax those sales as well, attracting the ire of smokers and the blessing of some groups ordinarily opposed to tobacco tax increases.

The New York Department of Taxation and Finance was scheduled to begin collecting sales taxes on tobacco sold by Indian vendors on December 1. That action has been postponed until at least March, as Governor George Pataki's tax department says it needs more time to study the issue. "In light of the com-

INDIAN p. 18

Massachusetts Gov. Gets Passing Grade

by Frank Conte

Having fended off pressure to raise taxes in the face of a FY 2003 budget shortfall, Massachusetts Governor Mitt Romney is earning good grades. According to a report card devised by the Beacon Hill Institute

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STATE SPENDING

Frugal South Carolina Governor Finds State Government a Tough Sell

by Jason White

On a recent trip to West Virginia, South Carolina Governor Mark Sanford (R) decided to save his state a few dollars by booking one hotel room for both him and his press secretary.

Problem is, the room had only one bed.

"At least he made-up the couch for me," said press secretary Will Folks.

Sanford's penny-pinching ways are by now the stuff of legend. During his three terms in Congress, he made a name for himself by sleeping on his office couch and returning his housing allowance to the federal treasury. That saved the federal government $3,000 a month. Now, as a first-year governor, Sanford is trying to bring his model of personal efficiency to the structure of state government, which even he admits is a tough sell.

"I think we have a real problem in government in that we generally don't spend money like it's our own. We'll begin next year's budget $350 million in the hole. A hotel room ain't gonna make or break it one way or the other. But this is indicative of the way I want our shop to run," Sanford told Stateline.org.

Sanford assumed the governorship last January after beating incumbent Jim Hodges (D) in the November election. Sanford ran as an outsider, promising to restructure and streamline state government. His approach has yielded some successes.

"We've cut the size of the commerce department by 26 percent. We've gone from four floors down to two. We've gone from 11 divisions down to four. You want to talk about something that was exempt from state scrutiny, that's commerce. And though it was an entity built around reaching out to the businessperson, it wasn't built on a business-like basis," Sanford said.

But Sanford's first year has had its struggles too. His government restructuring plans, which include making elected statewide positions such as the education superintendent, the treasurer, and the secretary of state positions appointed by the governor, have been coolly received by the legislature and the public. And his relations with South Carolina's political establishment have been notably rocky.

"I think it's important to note that Sanford is the first governor in half a century not to be a product of the General Assembly. Once you put that in perspective, you understand that anybody coming into this position, not having served in the General Assembly, not having built relationships, will have to take time to build those relationships," Rep. David H. Wilkins (R), the speaker of the House, told Stateline.org.

But that kind of relationship-building and the wheeling-and-dealing it often entails does not come naturally to the governor, said Brad Warthen, editorial page editor of *The State* (Columbia).

www.gov.sc

"[South Carolina Governor Mark] Sanford's penny-pinching ways are by now the stuff of legend. During his three terms in Congress, he made a name for himself by sleeping on his office couch and returning his housing allowance to the federal treasury."

"He's a real puritan. He cannot stand politics as usual. When somebody he has to deal with politically comes to him and says, 'Hey, you've got this appointment to make, could you appoint my brother-in-law?' he is just appalled," Warthen said.

In addition to fiscal conservatism, Sanford is known for his strong views on states' rights. During a recent meeting with Homeland Security Chief Tom Ridge, for example, Sanford criticized the extent to which the strings attached to federal security funds are shaping policy decisions at the state level.

"We're wasting a lot of money buying stuff that won't be used," Sanford recounted to Stateline.org. "My point was you [Ridge] have to give us more flexibility."

The issue of homeland security aside, Sanford's focus on states' rights, a focus that cuts across many issues, is unnerving for some people in the South Carolina civil rights community.

"I think when he says it, he says it with pure motives. When other folk say it, I hear a return to the antebellum South. But it's hard to separate that out sometimes," said Joe Darby, pastor of Morris Brown AME Church and an official with the local and state chapters of the NAACP.

Darby nonetheless praised Sanford for trying to be an inclusive governor, even if that hasn't meant shaping public policy in a way that's favorable for African-Americans.

"He really wanted to get some black folk in his administration who shared his concerns and Republican philosophy, but they are as scarce as hen's teeth in South Carolina," Darby said.

For his part, Sanford said he will continue to fight for a strong state role in the federal system, whether the issue in play is homeland security, energy, or social services. In the process, he said, perhaps he'll help rehabilitate a loaded phrase.

"States' rights have meant bad things in the past. But that can't help it from meaning either good or bad in the future based on what we decide to do with it," he said.

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U.S. Companies Become EU Tax Collectors

by Veronique de Rugy

Since July 1, U.S. firms selling certain goods to customers in the European Union (EU) have been required, under a law passed by the EU last year, to act as tax collectors on behalf of EU officials.

Concerned that overtaxed consumers might otherwise escape the EU's value-added tax (VAT), member countries adopted on May 7, 2002 a plan that imposes the VAT on software, videos, computer games, and music downloaded via the Internet from non-EU companies. The EU claims the extra-territorial tax scheme is necessary to level the playing field for its own retailers.

European companies traditionally add a VAT to the services and products they sell online. A Dutch company collects the Dutch tax on any online products it sells, regardless of where the customer lives.

By contrast, companies headquartered outside the EU impose only the taxes required by their national governments. They have not collected an EU value-added tax on sales to EU customers, because the point of sale is not in the EU.

The EU's new VAT on Internet sales changes that dynamic, by shifting the point of taxation from where the good is *sold* to where it is *consumed*. Under the new VAT, a U.S. company selling to an EU customer is expected to collect the VAT and remit it to the EU government.

Revenue Bonanza

As the cost of international shipping continues to fall, highly taxed Europeans are increasingly turning to the Internet for tax-free purchases. In July, Amazon.com reported that its international sales are growing faster than its North American sales, thanks mostly to Europe's "big three" Internet markets: Germany, France, and the United Kingdom. In 2002, according to Amazon.com, those countries accounted for 70 percent of the e-commerce in Europe.

A study by Emarketer, which conducts Internet and e-business research and analysis, projected that in 2004 the United States will have 168 million Internet users, 75 percent of whom will be online buyers. In Europe, the group projected, 221 million people—86 percent of whom will be shoppers—will be online.

Provided non-EU companies comply with the VAT requirement, the revenue potential could be huge. Some of the revenue would be offset by the VAT measure's new export preference, which excludes from the VAT sales to U.S. customers by EU companies. That concession costs the EU little, however, because few foreigners buy from EU firms.

Extending the VAT to Internet purchases by EU consumers is also unlikely to do serious damage to the Internet economy; that market is certainly big enough to absorb the loss of some EU customers. And there is virtually no political cost: Non-EU companies do not vote in Europe, and the new tax revenues will allow EU member countries to score political points with new or expanded government services.

Perpetuating Tax-and-Spend Mentality

By imposing the VAT on Internet sales, EU politicians expect to be able to continue their tax-and-spend ways without suffering any consequences for their behavior. They accuse non-EU nations of "poaching" their taxpayers—as if their citizens are tax slaves, perpetually bound by the tax laws of their home government regardless of where they work, save, shop, or invest.

The EU's approach completely reverses causality. It is not "poaching" by more-responsible governments that makes cross-border shopping attractive. Rather, European consumers are shopping elsewhere because the EU has made it too expensive to shop domestically, by requiring all member nations to harmonize their value-added taxes at a rate of at least 15 percent.

Non-European businesses to have three options for responding to the new VAT.

First, they can register their business and set up headquarters in an EU country. They would then pay that country's tax rate on sales to customers in any EU country. That is the option chosen by America Online, which will move its European headquarters to EU's lowest-VAT country, Luxembourg. Exercising this option is complicated and costly but, according to an AOL spokeswoman, "it certainly beats the alternative."

The second option is for non-EU companies to pay the tax rate for the country where the customer lives, ranging from 15 percent in Luxembourg to 25 percent in Sweden. Companies exercising this option must collect information about each customer and comply with the rules of several tax jurisdictions. Amazon.com opted for this approach after it realized how much the new regulation would affect its operations through which third-party new and used items are sold. By assessing the VAT on each of its commissions, Amazon will see its costs increase significantly.

Finally, non-EU companies can ignore the new regulation. In theory, the cost of noncompliance could be steep: The EU threatens to force "cheaters" to pay back taxes plus fines up to 200 percent of the back taxes, among other penalties. Yet the EU measure makes no provision for how it will enforce this rule against smaller companies with no EU presence.

Dangerous Precedent

The high cost and complexity of complying with the EU tax—not to mention the indignity of having been drafted as European tax collectors against their will—are not the only reasons U.S. companies feel threatened by the measure.

E-commerce companies are also worried the EU initiative might fuel efforts by state and local governments in the U.S. to tax domestic interstate e-commerce. "Companies will have to put in place procedures and software to implement VAT, and once they've done that it's relatively easy to do the same in the U.S.," explained James Lewis, director of the technology and public policy program at the Center for Strategic and International Studies.

To date, Internet retailers in the U.S. have been protected by the Supreme Court's 1992 *Quill* decision, which determined states may not require out-of-state retailers to collect and remit sales taxes if the retailer does not have a substantial physical presence in the state. To bypass that "nexus" requirement would require an act of Congress.

Veronique de Rugy is a policy analyst at the Cato Institute in Washington, DC. Her email address is **vderugy@cato.org**.

History of the FSC Dispute

by John Skorburg

The U.S. first adopted Foreign Sales Corporation (FSC) legislation in 1985 to encourage the export of U.S.-manufactured goods. The legislation provided that certain income earned by a foreign subsidiary of a U.S. corporation would not be subject to taxes in the U.S.

In February 2000, the World Trade Organization's Appellate Body issued a final ruling on a complaint against the FSC program filed in 1997 by the European Union. The WTO rejected the FSC tax break, ruling that such programs, which are contingent upon export performance, violate WTO rules against export subsidies.

The U.S. responded to the WTO decision by adopting in November 2000 the FSC Repeal and Extraterritorial Income Exclusion Act (ETI). The move satisfied neither the European Union nor the WTO, and on January 14, 2002 the WTO Appellate Body ruled the U.S. had not complied with its earlier ruling. The U.S. failed to take corrective action, leading to the May 7, 2003 decision by the WTO Dispute Settlement Body to permit the EU to impose countermeasures against the U.S.

To date, the EU has declined to implement the sanctions it has been authorized to impose, because U.S. political leaders have pledged to comply with the WTO ruling. CNSnews.com reported on November 11 that the EU plans to implement trade sanctions of $332 million starting next March, an amount that will rise by $30 million per month, and could reach $700 million per month by March 2005, unless the FSC program is halted.

John Skorburg is managing editor of Budget & Tax News. *His email address is* **skorburg@heartland.org**.

How to Get Rid of Taxes on Productive Effort

Don't tax buildings in the property tax! Tax land assessments instead. No one produced land (God did, many years ago). Your town won't shrink if land assessments are taxed, but there are fewer buildings and less renovation because buildings are taxed.

Cutting taxes on buildings will promote more buildings and renovation. Raising taxes on land values would encourage landowners to develop their sites more fully, also resulting in more buildings, more renovation.

Visit www.EconomicBoom.info for more information, especially on how to implement it properly, or write to:

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About the WTO

The World Trade Organization (WTO) is headquartered in Geneva, Switzerland and was established on January 1, 1995. It is charged with administering rules for trade, negotiated by consensus and set out in the form of a contract, among its 148 member countries. Nations that join the WTO have an obligation to abide by its rules and the right to seek action against other members who fail to do so. Although the U.S. is a member, WTO rules are subordinate to and cannot supersede laws established by the U.S. Constitution. The WTO's primary function, according to its Web site, "is to ensure that trade flows as smoothly, predictably, and freely as possible."

— *J.S.*

INTERNET INFO

For more information visit the World Trade Organization's Web site at **http://www.wto.org**.

WTO

Continued from page 1

enues from the federal income tax. FSC law allows U.S. firms with foreign subsidiaries to exclude from federal income tax calculations a share of their net income from the export of goods made in the United States.

Opponents in the EU, who estimate U.S. exporters save as much as $5 billion a year through the FSC mechanism, say it gives U.S. firms an unfair trade advantage. The WTO agrees, first ruling against the FSC in February 2000. (See "History of the FSC Dispute.")

On May 7, the WTO granted the EU permission to sanction the U.S. by increasing by $4 billion its import tariffs on U.S. goods—everything from agriculture and wool to jewelry and steel. U.S. officials have until the end of the year to correct the situation; the EU tariff is scheduled to go into effect March 1, 2004 if they don't.

"The WTO decisions put the United States in a difficult position," said Daniel J. Mitchell, Ph.D., a senior fellow in political economy at The Heritage Foundation. "If our law is not repealed, the EU has the right to impose more than $4 billion of compensatory tariffs on American products each year. These taxes on U.S. exports, which could be as high as 100 percent, would fall on over 1,800 different products including agriculture, jewelry, steel, machinery and mechanical appliances, wool and cotton textiles, and toys.

"Yet repealing the law," continued Mitchell, "means higher corporate income taxes—also about $4 billion annually—for companies that benefit from the law. This seems like a no-win situation—either higher taxes on corporate income or higher taxes on exports."

An Unexpected Opportunity?

But all is not lost, said Mitchell. "While not desirable, the WTO decisions could be a blessing in disguise if they spurred much-needed tax reform," he explained in a September 25 *Backgrounder* for Heritage.

"Ideally, lawmakers should engage in wholesale change, junking America's worldwide tax system (whereby companies are taxed on income earned in other countries) and replacing it with a territorial tax system (the common-sense practice of taxing only income earned inside national borders). This reform would allow U.S.-based companies to compete with foreign competitors, particularly if it is accompanied by a significant reduction in the corporate tax rate."

Mitchell acknowledged that a wholesale shift to territorial taxation would be a major undertaking, especially given the pressure to act quickly in order to avoid EU sanctions. But even incremental reform, he said, could significantly improve U.S. competitiveness and boost economic performance. He recommended, for example, that lawmakers consider reforms that would:

- *Make interest expense allocation less onerous.* Companies should not be required to pretend some interest costs are incurred overseas, a policy that results in higher tax burdens.
- *Reduce foreign tax credit baskets.* Companies should not be required to engage in complicated calculations that limit their ability to avoid double taxation.
- *Allow deferral of foreign base company sales and services income.* Companies should not be required to pay U.S. tax when a subsidiary in one foreign country sells to a subsidiary in another foreign country, so any delay in a U.S. tax liability is a positive step.
- *Protect against expiring foreign tax credits.* Companies should be allowed to benefit fully from their foreign tax credits to minimize the adverse impact of worldwide taxation.
- *Permit repatriation of overseas income.* Companies should be encouraged to bring profits back to the U.S., a policy that will boost domestic investment and move the tax code closer to a territorial system.

Other Economists Agree

In an October letter to Congress (see page 5), several economists joined Mitchell in asking for Congressional action on foreign tax reform. They urged a vote on H.R. 2896, a measure introduced on July 25 by Representative Bill Thomas (R-California). The measure would "amend the Internal Revenue Code of 1986 to remove impediments in the Code and make our manufacturing, service, and high-technology businesses and workers more competitive and productive both at home and abroad." On October 28, a House committee ordered the bill to be reported and amended.

John Skorburg is managing editor of Budget & Tax News. *His email address is* **skorburg@heartland.org**.

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OPEN LETTER

Help U.S. Companies Compete Globally with New Tax Code

TO:

OCTOBER 10, 2003

The Honorable William Thomas
Chairman
Committee on Ways and Means
United States House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Chairman Thomas:

By taxing income earned in other nations and imposing high tax rates, the current United States tax system violates important principles of good tax policy. These anti-growth features undermine the economy's performance and hinder the ability of American firms to compete in the global economy. More specifically, the tax code unduly raises the cost of capital for U.S. firms trying to invest, taxes profits at a rate far higher than do our trading partners, and is littered with complex rules that often result in double taxation of foreign income while many countries do not tax active foreign income at all.

We are writing to commend you for seeking to reform the tax treatment of international business income. Your proposed legislation, H.R. 2896, the "American Jobs Creation Act of 2003," takes important, fundamental steps towards a territorial, consumption-based tax system. This will improve the competitiveness of the U.S. tax code and help create a level playing field for U.S.-based companies. These changes will allow U.S. firms to expand both domestically and internationally and will increase U.S. employment.

In addition, we would like to recognize important provisions in your bill that lower the cost of capital, encourage investment, and make another step forward towards a neutral, progrowth tax code. Specifically, reducing the depreciation lives for equipment is a commendable step forward in the quest for a consumption-based tax system that allows investment to be immediately expensed.

Although we are disappointed that the World Trade Organization (WTO) and the European Union are attempting to dictate U.S. tax law, we believe that enacting H.R. 2896 will result in a tax code that better promotes U.S. business both within the U.S. and abroad. Such changes will result in greater productivity, output, and employment.

SINCERELY,

Glenn Hubbard
Columbia University

Kevin Hassett
American Enterprise Institute

Daniel Mitchell
The Heritage Foundation

Veronique de Rugy
Cato Institute

Richard Rahn
Discovery Institute

Charles Calomiris
Columbia University

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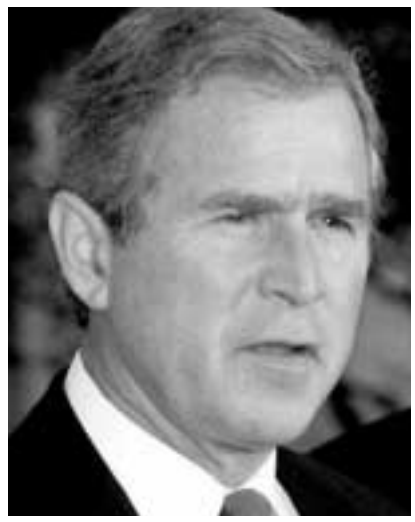
Lagging in Polls, Lieberman Offers Tax Hike



MARRIED TAXPAYERS, FILING JOINTLY

Bush Tax Cut		Lieberman Tax Hike	
Adjusted Gross Income	Tax Rate	Adjusted Gross Income	Tax Rate
$0 - $14,000	10%	$0 - $14,000	10%
$14,000 - $56,800	15%	$14,000 - $56,800	12.5%
$56,800 - $114,650	25%	$56,800 - $114,650	22.5%
$114,650 - $174,700	28%	$114,650 - $150,000	28%
$174,700 - $311,950	33%	above $150,000	39.6%
above $311,950	35%		

SINGLE TAXPAYERS

Bush Tax Cut		Lieberman Tax Hike	
Adjusted Gross Income	Tax Rate	Adjusted Gross Income	Tax Rate
$0 - $7,000	10%	$0 - $7,000	10%
$7,000 - $28,400	15%	$7,000 - $28,400	12.5%
$28,400 - $68,800	25%	$28,400 - $68,800	22.5%
$68,800 - $143,500	28%	$68,800 - $143,500	28%
$143,500 - $311,950	33%	above $143,500	39.6%
above $311,950	35%		

IN the early October CNN poll, retired Gen. Wesley Clark led all contenders for the Democratic Party's Presidential nomination, with 21 percent of respondents saying they would most likely support Clark in 2004. That was down one point from the previous poll, taken in September.

Clark was followed by former Vermont Gov. Howard Dean, with 16 percent; Connecticut Sen. Joseph Lieberman, 13 percent; Massachusetts Sen. John Kerry, also 13 percent; and Missouri Rep. Dick Gephardt, 8 percent.

Four hundred Democrat or Democrat-leaning registered voters were polled by telephone and asked which candidate they were most likely to support for the party's 2004 nomination. The poll had a margin of error of plus-or-minus 5 percentage points.

by John Skorburg

Presidential hopeful Senator Joe Lieberman (D-Connecticut) fell into a tie for third place among Democrats running for their party's Presidential nomination, according to an early fall CNN poll. Within days of the poll's release, Lieberman issued a tax reform plan that would, according to his campaign Web site, increase taxes on the nation's top wage-earners by up to $700 billion over 10 years.

"You gotta feel for Joe," wrote economist Alan Murray of CNBC. "Presidential hopeful Joseph Lieberman has proposed a Robin Hood tax plan to try to stand out in a crowded Democratic field."

"Joe Lieberman's call for higher taxes on small businesses and investors demonstrates he is against all American taxpayers," said Grover Norquist, president of Americans for Tax Reform. "This $1 trillion tax increase proposal further accelerates his ongoing shift from being a 'New Democrat' to the outer fringes of the left wing."

Lieberman would reinstate the 39.6 percent top marginal tax bracket that was lowered to 35 percent by the tax cuts implemented by President George W. Bush. Married taxpayers with household incomes of more than $150,000, and individuals with incomes above $143,500, would fall into the new top bracket. Currently those taxpayers pay an income tax of 33 percent, and only those with incomes over $311,950 pay the highest rate (35 percent).

"Since the rich already pay the largest percentage of taxes, Lieberman's plan simply fuels the liberal notion that success deserves to be penalized and failure subsidized."

CAL THOMAS
SYNDICATED COLUMNIST

In addition, Lieberman would "apply a 5 percent surtax to all married couples with adjusted gross incomes of about $250,000 and higher (and the equivalent income level for single filers)," according to his Web site.

"Since the rich already pay the largest percentage of taxes, Lieberman's plan simply fuels the liberal notion that success deserves to be penalized and failure subsidized," wrote syndicated columnist Cal Thomas.

Lieberman's plan would lower tax rates for single taxpayers making between $7,000 and $68,000, and for married taxpayers earning between $14,000 to $114,650. Nevertheless, the net effect of the Lieberman proposal would be a tax increase of $700 billion over 10 years.

Political candidates who hope to win their elections should not be calling for tax hikes, according to Norquist. "The 2003 elections were elections overwhelmingly dominated by the tax issue. The sentiment that 'enough is enough' where taxes are concerned has taken a firm hold at both the state and federal levels.

"Taxpayer candidates won their races overwhelmingly in 2003," he continued, "and this is the realization of a trend against Big Government that Americans have seen since the late 1970s.

"Not a single tax increase has been signed into law at the federal level," Norquist added, "since Bill Clinton was President and the Democratic Party controlled Congress in 1993."

"If Mr. Lieberman wants to use smoke and mirrors to aggrandize a much-ballyhooed (plan)," editorialized the *Washington Times*, "he could at least do so without resorting to broken mirrors."

"It's an interesting tactic," said CNBC's Murray of the Lieberman plan, "one that has many of his natural allies scratching their heads. It gets him (Lieberman) off the Bush playing field, where moderate Democrats are forced to choose among the administration's policies they agreed with and those they disagreed with."

Soaking All Earners

If "soak the rich" tax plans such as Lieberman's play well at all in campaigns, it is because they are misrepresented by the politicians who promote them, according to economist Thomas Sowell, a senior fellow at the Hoover Institution at Stanford University, California.

"High tax rates hit people who are currently earning high incomes usually late in life, after having worked their way up in their professions over a period of decades," explained Sowell in a midsummer column that appeared on his Web site.

"In other words," he continued, "soak-the-rich tax rates do not in fact soak the rich. They soak people who are currently earning the rewards of having contributed to the economy. High income taxes punish people for becoming prosperous, not for having been born rich."

Lieberman defended his political plans by promising he will "lead with integrity. There may be debate about some of my actions, but there will never be any distrust in my motives. My only interest will be the nation's interest."

But many observers saw Lieberman's plan as mostly a benefit to campaigning Republicans, including Bush, who continues to promote broad tax cuts. Noted Thomas, "[Net] tax cuts are not only a winning political issue, they are a winning economic issue ... but only if Republicans can again demonstrate thrift and personal responsibility instead of behaving like Democrat-lite.

"Democrats are wrong about taxes," Thomas continued. "But Republicans are wrong about spending. If Republicans can control themselves, their position as the majority party will be secure for years to come."

John Skorburg is managing editor of Budget & Tax News. *His email address is* **skorburg@heartland.org**.

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Pennsylvanians Oppose New Sales Tax on Beer

by Diane Carol Bast

The Pennsylvania General Assembly returned to Harrisburg on November 17 to take up, among other items, a proposal to extend the state's 6 percent sales tax to beer, wine, and liquor sold by the glass—not only in bars, taverns, and restaurants, but also in hunting lodges and by fraternal clubs and volunteer fire companies.

"It would upset a lot of people in clubs like ours," Jack Cole, lodge secretary for a Pennsylvania Elks Club, told *Pittsburgh Post-Gazette* reporter Tom Barnes on November 10. "It would take away from money we give to charity, such as drug education for youths, athletic programs such as youth baseball and hockey, and essay contests where students talk about what the flag means to me."

"There are about as many tax proposals as there are legislators. Taxes on cigarettes are ... probably about as high as they can go. So other proposals like the beer tax are likely to gain some traction in the coming weeks."

LOWMAN HENRY, CHAIRMAN AND CEO LINCOLN INSTITUTE OF PUBLIC OPINION RESEARCH

In October, the Pennsylvania House of Representatives passed a state income tax increase to help address the state's $2.4 billion deficit—eighth highest in the nation, according to the American Legislative Exchange Council. The Republican-dominated state senate opposes the income tax increase and is looking to the "drink tax" as an alternative. They estimate it would raise up to $130 million a year, which would allow at least a lowering of the income tax increase.

"There are about as many tax proposals as there are legislators," noted Lowman Henry, chairman and CEO of the Harrisburg-based Lincoln Institute of Public Opinion Research. "Taxes on cigarettes are hiked routinely, and are probably about as high as they can go. The House has passed a personal income tax increase, but the Senate is refusing to agree—so other proposals like the beer tax are likely to gain some traction in the coming weeks."

Matthew J. Brouillette, president of The Commonwealth Foundation, a free-market public policy research and educational institute also based in Harrisburg, warned in April that a beer tax increase would hurt the state's already-weak economy.

"While the beer tax increase may initially generate more revenue for the government from consumers," Brouillette observed, "the tax will eventually come down hardest on independent breweries, small 'mom and pop' beer distributors, taverns, restaurants, and their respective employees as consumers seek alternative sources outside Pennsylvania."

"[B]usinesses across Pennsylvania should ask themselves one simple question," Brouillette wrote: 'When will our products or services be targeted?' Given state government's insatiable appetite for more tax dollars, a junk food excise tax on the likes of Herr's potato chips, Hershey's chocolate, or Philadelphia-produced TastyKakes is probably not far behind."

Eric Montarti, a policy analyst for the Pittsburgh-based Allegheny Institute for Public Policy, told *Budget & Tax News* his organization opposes the beer tax increase "because it would fund the expansion of government."

He noted, however, that a reasonable policy compromise would be for state lawmakers to open wine and beer sales to competition. "The retail sale of beer and wine is still tightly controlled here," Montarti noted. "You can't buy a bottle of wine or a six-pack of beer in a convenience store or in a grocery store."

Although the state has launched a few small experiments with making retail sales more convenient—by opening state-run liquor stores within grocery stores, for example—Montarti said that's not enough.

"We don't think a drink tax increase is called for," Montarti said. "But if lawmakers are going to do that anyway, they ought to give us deregulation in return. They should open wine and beer sales to competition."

Diane Carol Bast is vice president of The Heartland Institute. Her email address is **dbast@heartland.org**.

Congress Considers Rolling Back Federal Beer Tax

by John Skorburg

As Pennsylvania lawmakers ponder a new "drink tax," Congress is considering a rollback of federal excise taxes on beer.

A bipartisan group of House lawmakers, led by Representatives Phil English (R-Pennsylvania), Earl Pomeroy (D-North Dakota), and Christopher Cox (R-California), reintroduced on March 18 legislation to roll back the federal beer excise tax by 50 percent to its pre-1991 level, $9 per barrel. The legislation, H.R. 1305, currently has 168 cosponsors, and its sponsors expect to surpass the 226 supporters the legislation attained last year.

A similar measure, S. 809, is pending in the Senate.

"The beer tax is a non-sensical, anti-consumer, prohibitionist throwback. It's past time that we roll back the beer tax," said English.

The 1991 doubling of the tax, to $18 per barrel, is the only remaining "luxury tax" of several enacted in 1990. The others have been repealed.

According to the Beer Institute, the national trade association for the brewing industry, the excise tax doubling caused a loss of 31,000 jobs in brewing, distributing, retailing, and related industries. Taxes represent more than 44 percent of the price of beer.

"When a tax starts to approach half the cost of what Americans pay for any product, something has to be done," said Pomeroy. "It's time to roll back this tax."

Cox, who is chairman of the House Policy Committee, echoed Pomeroy's sentiments: "Middle-and lower-income Americans are hit hardest by this confiscatory tax. The less expensive the brand, the higher the tax rate. The 90 million average Americans who indulge in the 'luxury' of purchasing beer are now paying some of the steepest tax rates in our society."

Jeff Becker, president of the Beer Institute, expressed hope Congress will act soon to rollback the tax.

"It is way overdue for Congress to rollback the doubling of the beer excise tax that has damaged the beer industry economically and disproportionately impacts low and middle income American consumers. We are hopeful that the overwhelming support for the beer tax rollback will encourage Congress to act."

John Skorburg is managing editor of Budget & Tax News. *His email address is* **skorburg@heartland.org**.

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Dealing with Uncle Sam

District of Columbia, New Mexico, and North Dakota get best deal from the federal government; New Jersey, New Hampshire, Connecticut trail

by Scott Moody

All taxpayers know that the federal government uses tax and spending policy to redistribute income from citizens with high incomes to those who earn little. But most taxpayers are less aware of how the government also redistributes income based on geography.

Comparing the Census Bureau's 2002 data on federal spending in each state with information on each state's federal tax burden allows states to be ranked according to the "bang for the buck" each got from Uncle Sam's tax and spending policies.

In FY 2002, New Mexico received $2.37 from the federal government for every $1.00 the state's taxpayers sent to Uncle Sam. Only one other state got a 2-1 ratio: North Dakota, where Uncle Sam spent $2.07 for each tax dollar. Other big winners were Alaska ($1.91), Mississippi ($1.89), and West Virginia ($1.82).

Combining the third-highest tax burden per capita with the ninth-lowest federal spending, New Jersey had the lowest federal spending-to-tax ratio (62¢). Other states with low federal spending-to-tax ratios in FY 2002 were Connecticut (65¢), New Hampshire (66¢), Nevada (74¢), Massachusetts (75¢), and California (76¢).

District of Columbia's Special Status

Though not comparable as a state, the District of Columbia is by far the biggest beneficiary of federal spending: In 2002 it received $6.44 in federal outlays for every dollar its taxpayers sent to the U.S. Treasury.

The District's share of federal largesse amounted to $58,347 for every man, woman, and child living there. That is more than nine times the national average, and it includes more than $8,000 per person in grants, more than $19,000 per person in procurement, and more than $24,000 per person in federal wages.

Those funds are rarely mentioned by District lawmakers who assert that being the site of the federal government is a major financial burden.

States That Help Others

If some states are beneficiaries, then naturally some must be benefactors—those states where so much is collected in federal taxes that any federal spending they receive is overwhelmed.

New York has often been the biggest payer in the Tax Foundation's annual comparison of taxes to spending, which inspired Daniel Patrick Moynihan and the Kennedy School of Government to launch their annual reference book comparing state taxes with spending (**http://www.ksg.harvard.edu/fisc99**) more than 25 years ago. In recent years, however, other states have eclipsed New York for the "honor" of being the state that gives far more than it receives.

"In FY 2002, New Mexico received $2.37 from the federal government for every $1.00 the state's taxpayers sent to Uncle Sam. ... New Jersey had the lowest federal spending-to-tax ratio (62¢)."

Changing Ranks

The state that raised its ratio the most over the past 10 years is Alaska, where federal spending rose from $1.26 to $1.91 for each dollar in taxes. That 65¢ increase beats out North Dakota, where federal spending increased 53¢ per dollar of tax, North Dakota (43¢), and West Virginia (38¢).

The ratio fell most dramatically in Colorado and Massachusetts. Colorado has seen its federal spending-to-tax ratio fall 28¢ from $1.06 in FY 1992 to 78¢ in FY 2002. Massachusetts's fell 27¢.

What to Do?

Federal spending on defense and other procurement dollars are often funneled to the states of powerful congressmen, and state governments can grab more federal grant money by skillfully—some would say slavishly—manipulating their spending to comply with federal regulations.

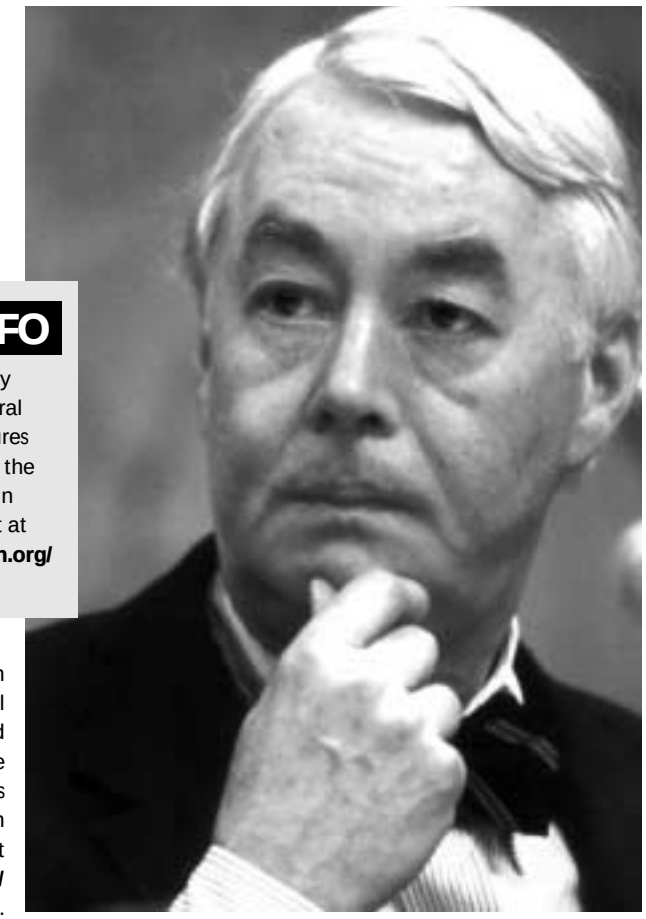
Demography, however, is at least as influential as politics. States with more residents on Social Security, Medicare, and other large federal entitlements are bound to rank fairly high. Similarly, the high spending levels in Virginia, Maryland, and the District of Columbia are explained by the predominance of federal employees.

On the tax side of the equation, states with higher incomes per capita—Connecticut stands out—pay much higher federal taxes per capita because of the income tax's progressive structure. The citizens in these high-income, high-tax states do not always live better or save more than people in low-income, low-tax states because the higher cost of living is usually that much higher or more.

Scott Moody is senior economist for the Tax Foundation. His email address is **moody@taxfoundation.org**.

INTERNET INFO

The full text of Moody's July 2003 *Special Report*, "Federal Tax Burdens and Expenditures by State," is available from the Tax Foundation's Web site in Adobe Acrobat PDF format at **http://www.taxfoundation.org/sr124.pdf**.



Daniel Patrick Moynihan and the Kennedy School of Government launched their annual reference book comparing state taxes with spending more than 25 years ago. Find it at **http://www.ksg.harvard.edu/fisc99**.

New Coalition Fights to End Tax Discrimination against Self-Employed

American Farm Bureau Federation

Equity for Our Nation's Self-Employed, a new coalition of small business trade associations, including the American Farm Bureau Federation, has come together to fight a tax code discrimination that penalizes self-employed Americans.

Current tax law requires sole proprietors to pay 15.3 percent in self-employment tax (FICA tax) on their health insurance premiums, while larger businesses are able to deduct this expense as a regular cost of doing business. Equity for Our Nation's Self-Employed supports H.R. 1873, the Self-Employed Health Care Affordability Act, to fix that disparity.

The average self-employed individual pays $7,954 annually in health insurance premiums for family coverage, according to a 2002 Kaiser Family Foundation study. Under the current tax code, that sole proprietor would pay $1,217 (15.3 percent) in self-employment taxes on this amount, while other business entities can fully deduct their health costs.

"Other business owners have the opportunity to pay for health insurance premiums before any tax calculation is applied to the earnings of their officers and employees," said Keith Hall, a self-employed certified public accountant from Dallas, Texas. "This means that before anything else is taken into consideration, the cost of my health insurance is up to 15.3 percent higher than the owner of the business next door, solely because I am self-employed. He may have the same size family, the same health concerns, and the same medical history, but I will still pay 15 percent more for my coverage than he does simply because the Internal Revenue Code does not allow me to fully deduct my health insurance premiums."

"The Self-Employed Health Care Affordability Act, H.R. 1873, would level the playing field for the self-employed and allow them to fully deduct their health coverage costs."

The Self-Employed Health Care Affordability Act, H.R. 1873, would allow the self-employed to fully deduct their health coverage costs. H.R. 1873 comes at a time when small business owners face uncertainties in how they will fare in the current economic conditions and are anxious to recover cash for the day-to-day operations of their businesses.

For self-employed individuals like Christine Krupinski, it is time for the federal government to step up to help "Main Street" businesses.

"I would love to buy new graphic design tools for my business, but don't have the money to," said Krupinski, owner of CK Art and Design in Fairfax, Virginia. "But if I were able to save the extra money that I pay in taxes on my health insurance premiums, I would be able to purchase the tools, putting that money back into the economy while bettering my business."

The added cost on top of already skyrocketing premiums is also often a deterrent for the self-employed to purchase health insurance. Today, more than 60 percent of the 41 million uninsured Americans are from families headed by a self-employed person or a person working for a small business.

INTERNET INFO

For more information on the self-employment tax on health insurance premiums, visit **http://www.taxequity.org.**

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Federal Spending per Dollar of Taxes - 1992 and 2002

	Expenditures per Dollar of Taxes		10-Year Change in Spending per Dollar of Tax	Ranking		Change in Ranking
	FY 1992	FY 2002		FY 1992	FY 2002	
Alabama	$ 1.39	$ 1.64	+26¢	7	7	0
Alaska	$ 1.26	$ 1.91	+65¢	14	3	-11
Arizona	$ 1.17	$ 1.21	+3¢	19	22	3
Arkansas	$ 1.28	$ 1.55	+27¢	13	10	-3
California	$ 0.93	$ 0.76	-16¢	38	45	7
Colorado	$ 1.06	$ 0.78	-28¢	26	42	16
Connecticut	$ 0.68	$ 0.65	-2¢	49	49	0
Delaware	$ 0.72	$ 0.85	+13¢	48	41	-7
Florida	$ 1.08	$ 1.01	-7¢	24	33	9
Georgia	$ 1.00	$ 1.01	+1¢	32	32	0
Hawaii	$ 1.14	$ 1.57	+43¢	21	9	-12
Idaho	$ 1.25	$ 1.31	+6¢	16	18	2
Illinois	$ 0.72	$ 0.77	+4¢	47	44	-3
Indiana	$ 0.83	$ 1.00	+17¢	41	34	-7
Iowa	$ 1.05	$ 1.23	+18¢	28	20	-8
Kansas	$ 1.05	$ 1.13	+8¢	27	25	-2
Kentucky	$ 1.20	$ 1.50	+29¢	18	13	-5
Louisiana	$ 1.29	$ 1.48	+19¢	11	14	3
Maine	$ 1.48	$ 1.34	-14¢	4	16	12
Maryland	$ 1.25	$ 1.22	-3¢	15	21	6
Massachusetts	$ 1.01	$ 0.75	-27¢	31	46	15
Michigan	$ 0.83	$ 0.88	+6¢	42	38	-4
Minnesota	$ 0.77	$ 0.77	-1¢	44	43	-1
Mississippi	$ 1.84	$ 1.89	+5¢	2	4	2
Missouri	$ 1.25	$ 1.34	+9¢	17	17	0
Montana	$ 1.46	$ 1.67	+21¢	5	6	1
Nebraska	$ 1.07	$ 1.19	+12¢	25	23	-2
Nevada	$ 0.74	$ 0.74	0¢	45	47	2
New Hampshire	$ 0.74	$ 0.66	-8¢	46	48	2
New Jersey	$ 0.66	$ 0.62	-3¢	50	50	0
New Mexico	$ 2.08	$ 2.37	+29¢	1	1	0
New York	$ 0.86	$ 0.85	-1¢	40	40	0
North Carolina	$ 0.95	$ 1.07	+13¢	33	29	-4
North Dakota	$ 1.54	$ 2.07	+53¢	3	2	-1
Ohio	$ 0.94	$ 1.03	+9¢	34	31	-3
Oklahoma	$ 1.30	$ 1.52	+22¢	10	11	1
Oregon	$ 0.94	$ 0.98	+4¢	36	35	-1
Pennsylvania	$ 1.02	$ 1.09	+7¢	30	27	-3
Rhode Island	$ 1.10	$ 1.08	-2¢	23	28	5
South Carolina	$ 1.29	$ 1.34	+5¢	12	15	3
South Dakota	$ 1.31	$ 1.61	+30¢	9	8	-1
Tennessee	$ 1.11	$ 1.26	+15¢	22	19	-3
Texas	$ 0.93	$ 0.92	0¢	37	36	-1
Utah	$ 1.17	$ 1.14	-3¢	20	24	4
Vermont	$ 0.94	$ 1.13	+19¢	35	26	-9
Virginia	$ 1.39	$ 1.50	+11¢	8	12	4
Washington	$ 0.89	$ 0.87	-2¢	39	39	0
West Virginia	$ 1.44	$ 1.82	+38¢	6	5	-1
Wisconsin	$ 0.82	$ 0.88	+7¢	43	37	-6
Wyoming	$ 1.02	$ 1.06	+4¢	29	30	1
District of Columbia	$ 5.86	$ 6.44	+58¢			

Source: Census Bureau; Tax Foundation's "State-by-State Tax Burden Allocation Model."

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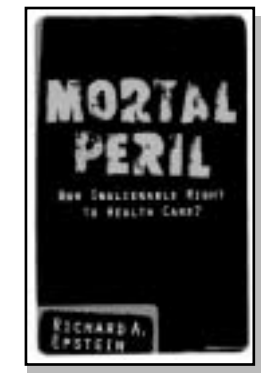

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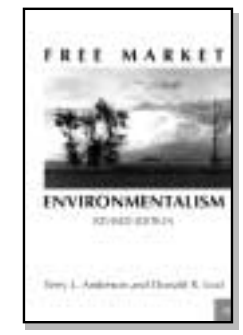

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TAX WATCH

ALEC Offers Friendly Advice for Arnold

by John Skorburg

The American Legislative Exchange Council (ALEC)—the nation's largest bipartisan, individual membership organization for state legislators—responded to Arnold Schwarzenegger's election with a little friendly advice on restoring the stability and vitality of the state's budget and economy.

"It's time for Democratic and Republican state legislators to work with California's new governor," said Duane Parde, ALEC executive director. ALEC offered the following "five suggestions as a beginning step toward piecing-back-together the vitality of California's shattered economy."

1. Reject the usual gimmicks

The borrowing and short-term fixes adopted by California in the past two budgets have been counterproductive, contributing to, rather than solving, California's fiscal problems. Schwarzenegger must seriously address the chief underlying problems with California's budget: an uncompetitive tax and regulatory environment and a need for efficiency in state spending.

2. Reform California's tax and regulatory environment

Only four states with a personal income tax have a higher top rate than California. To reinvigorate personal and business investment in the state, ALEC says, Schwarzenegger must cut California's personal income tax rates. California also has one of the worst business-tax climates in the country. If California wants to fully employ its workforce, the state has to stop treating businesses like villains and start treating them as partners.

3. Set goals and instill a culture of efficiency in government

In order to get state spending under control, Schwarzenegger needs to instill a culture of efficiency in state government. To do this, ALEC recommends, goals must be set for each agency; a determination must be made whether the public or private sector is best suited to meet those goals; and a system must be put into place for examining all government functions on an annual basis to make certain goals are being met.

4. Employ the "yellow pages" test

Government officials in California—and in all states—should employ the "yellow pages" test: If a service can be found in the yellow pages, it should not be directly provided by the state government. That simple maxim alone could save significant amounts of money each year.

5. Reduce workforce costs

Schwarzenegger must control the costs of the public-sector workforce. Competitive bidding, the elimination of phantom positions, public pension reform, and employment caps all can be used to bring public-sector labor costs under control.

John Skorburg is managing editor of Budget & Tax News. *His email address is* **skorburg@heartland.org**.

Schwarzenegger Inherits Huge Budget Challenge

by Chris Atkins

The ongoing California budget problem presents one of the toughest fiscal challenges any American state has ever faced. Arnold Schwarzenegger, the beneficiary of Californians' recall of Gray Davis, carries a clear mandate to fix the state's finances. But it will take the strength of Atlas to bear that burden.

Making a Mess

How did California get into its mess? Stephen Moore, president of the Club for Growth and previously a budget analyst for the Cato Institute, says California is in a "depression" and lays the blame mostly at the feet of Gray Davis.

"Although the bursting of the high technology bubble contributed," Moore acknowledges, "Davis bloated the state budget, raised taxes repeatedly, passed scores of new business regulations, badly fumbled the electricity crisis, converted the governor's office into a campaign financing operation, and allowed the leftists in the legislature to rule the roost."

John Berthoud, president of the National Taxpayers Union, blames government over-spending for California's fiscal disaster. "From 1990-2001, real per-capita general fund spending rose by 26 percent. In other words, for every dollar that the state was spending per person in 1990, just 11 years later it was spending $1.26—and that's above and beyond increases for inflation."

Moore adds that Schwarzenegger will "inherit a $100 billion budget that has grown by nearly 40 percent in the last five years." Moore also points out that California's business climate is notoriously hostile to entrepreneurs, pointing to requirements like domestic partner employee benefits and hiring protections for cross-dressers.

The new governor agrees the California budget is a mess. "It's disturbing to realize that after taking a close look at California's budget, it's hard to make any sense out of it," Schwarzenegger said.

"In Sacramento, spending is out of control and as governor, I will work to get the state's fiscal house in order," he pledged. "Immediately upon taking office I will order an outside, independent audit of the state budget so we can get a clear picture—uncluttered by politics and special interest influence—of how we can bring spending under control without neglecting our most important obligations."

Cleaning Up

Schwarzenegger wants to rein in spending by adopting a strict spending limit; going after waste, fraud, and abuse in the state budget; and restructuring some of the state's debt.

Moore agrees with the idea of a state spending cap, noting it is a vital reform. "If taxes and outlays had risen only as fast as inflation and population growth since 1990," Moore notes, "the average California family would be paying some $2,000 less per year in state-local taxes today and the budget would be balanced."

Moore also suggests the adoption of a California flat tax. "At 9.3 percent, the top tax rate on businesses and workers is the third highest in the nation. This has driven employers and high-wealth individuals from the state to places like Nevada and Washington that have no income tax. A 6 percent flat rate income and sales tax will bring some of those job-producers back."

"Arnold Schwarzenegger, the beneficiary of Californians' recall of Gray Davis, carries a clear mandate to fix the state's finances."

Fixing the workers compensation system is also on Schwarzenegger's agenda. California spends $80 million per 100,000 workers on workers compensation costs—dramatically more than is paid by neighboring states. To solve the problem, Schwarzenegger proposes to end "the incentives and loopholes that encourage unscrupulous lawyers and providers to game the system."

Under Pressure

Battle plans, however, rarely survive contact with the enemy. Can Schwarzenegger rein in spending, adopt a spending cap, cut waste, fraud, and abuse, and reform workers compensation in a legislature dominated by Democrats?

"Governor-elect Schwarzenegger will face great political difficulties achieving his goals in the highly partisan California legislature," said Berthoud. "A majority of members in both houses are supporters of bigger government and most members are in safe seats. This means few of the pro-spenders have any reason or incentive to bend their views, even in the face of the anti-tax message state-wide in the recall election."

"Schwarzenegger must go to war against the Democratic-dominated legislature," commented Moore.

Schwarzenegger himself takes a more accommodative approach, stressing he wants to be governor of all the people. "I want to be the people's governor. I will work honestly, without fear or favor, to do what is right for all Californians."

A tall order, especially given the composition of the California legislature. If he succeeds, though, Moore says Arnold "has a chance to put the bloom back in the rose in the state that was once California."

Chris Atkins is director of tax and fiscal policy for the American Legislative Exchange Council. His email address is **cdatkins@alec.org**.

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Commuter Taxes Hit at Philadelphia Hearing

by John Berthoud

City officials in Philadelphia were recently told to reduce their politically popular but economically destructive taxes on nonresident workers. The Philadelphia Tax Reform Commission received expert testimony at a public hearing in October 2003.

The National Taxpayers Union's director of government affairs, Paul Gessing, summarized a study he conducted this summer for the group's research arm, the NTU Foundation. Gessing testified that wage-based taxes targeting nonresidents who work in Philadelphia are economically self-defeating.

"Too many elected officials assume that imposing a tax on commuters who can't vote them out of office is a simple solution to budget ills," testified Gessing."The trouble is, taking workers for a ride hasn't helped city officials pay for their fiscal baggage as painlessly as they had hoped."

Nonresidents Already Taxed

In 1939, Philadelphia became the first U.S. city to levy a tax on everyone earning income within its limits. Since then, according to Gessing, at least 13 states have permitted localities to charge wage, payroll, or per-employee taxes regardless of residency. Several cities, including Atlanta, Indianapolis, New York, and Washington, DC are actively considering such taxes.

Philadelphia currently levies the highest wage tax on commuters in the nation, nearly 3.9 percent. Since its population peaked in 1950, Philadelphia has lost 500,000 people, 280,000 of whom left in the past decade alone. Those former residents took with them jobs, purchasing power, small businesses, and other economic activities. The total value of property in Philadelphia is less today than it was in 1970.

Gessing found that Birmingham, Detroit, Louisville, and Philadelphia—relatively high-tax cities that also tax commuters—have lost more than 1.35 million residents between 1970 and 2000, even as other cities rebounded toward the end of that period.

Gessing acknowledges some may argue that commuters who use a city's resources should be expected to contribute. He responds that commuters already do their share by shopping, patronizing restaurants, paying tolls, filling up at local gas stations, and participating in other after-work activities that add to the local tax base. Most cities spend half or more of their budgets on education and social services, he notes—services that are rarely, if ever, used by commuters.

"'Voting with your feet' is a phrase economist Charles Tiebout uses to describe the public's response to high taxes, and it is a phenomenon that commuter-taxers should note," Gessing concluded. "Whether they're in a car or on foot, people simply won't stand still for taxes that punish them for working in a city and living someplace else."

In November 2002, Philadelphia voters approved a ballot measure allowing for the creation of an independent body, the Philadelphia Tax Reform Commission, to recommend ways to reduce taxes to make Philadelphia more competitive with other jurisdictions in attracting and retaining residents, businesses, and jobs.

INTERNET INFO

Paul Gessing's testimony to the Philadelphia Tax Reform Commission, and his *Policy Paper* 141, "Commuter Taxes: Milking Outsiders for All They're Worth," are available online at **http://www.ntu.org**.

The commission has been conducting a comprehensive analysis of the current tax system and will make specific recommendations for reducing taxes in a final report that will be submitted to the mayor and city council before the end of the year. Recommendations expected to be in the final report include:

- Reduce the current wage tax for residents and nonresidents.
- Eliminate the business-privilege tax within 10 years and changes to other business taxes.
- Create a separate appeals board for property-tax assessments and a taxpayers' advocate to represent property owners.

John Berthoud is president of National Taxpayers Union. His email address is **jberthoud@ntu.org**.

New Mexico Rejects Gas Tax Hike

by John Skorburg

A special session of the New Mexico legislature closed on November 5 after rejecting a hike in the state's gasoline tax but approving a 3 cents per gallon increase in the diesel fuel tax.

The session was convened by Governor Bill Richardson on October 27 to consider a proposal made earlier that month by a blue ribbon tax reform commission. The 23-member commission called for cutting income taxes for low- and middle-income New Mexicans, making income tax rates more progressive, cutting taxes on medical services, and cutting business taxes.

To offset the revenue losses, the commission recommended raising fees and other taxes, including the motor vehicle excise tax, gasoline tax, and vehicle registration fees.

If fully implemented, experts projected, the commission's recommendations would have resulted in $135 million in tax increases. "No one, including Democrats, wants to run on a record of having voted for a tax increase," noted State Rep. Ted Hobbs (R-Albuquerque).

According to the Governor's office, "The vast majority of revenues in the [special session] bill come from those who use the road the most—trucks. And 75 to 80 percent of the trucks using our highways are not based here." The bill also increased yearly motor vehicle registration fees for residents by $12.50 per year when fully implemented.

High Gas Prices Already

Gasoline prices reached record levels in parts of New Mexico over the Labor Day weekend, and Richardson responded with public pronouncements against raising the state's gasoline tax. "A spike in fuel prices has caused tighter family budgets," Richardson told the Associated Press on September 1. "After talking to many New Mexico taxpayers and looking at the soaring prices of gasoline and looking at just so many burdens on families, I'm not going to add to them," he said.

If the blue ribbon commission's recommendations had been implemented, the state's gasoline tax would have risen from the current 17 cents a gallon to 22 cents by 2008. Taxes on other fuels, including diesel, would have risen from 18 cents a gallon to 24 cents a gallon during the same period.

A similar proposal to increase the gasoline tax by 5.4 cents a gallon died during the legislature's regular 2003 session. Richardson had opposed that measure as well.

A commission sub-committee chairman said his panel recommended increasing the gasoline tax after deciding "roads need more money." But Richardson countered, "Just about everyone is upset by the high gasoline prices."

Spending Cuts Next Up

With a new legislative session just around the corner, the Governor's office is bracing the legislature for possible spending cuts. According to David Harris, Richardson's chief economic advisor, "We're going to make an effort to reduce the budget, to bring it down to size."

Hobbs was pleased by that plan. "We keep talking about what we've done with taxes, and I didn't see anyone talking about dealing with the budget. I'm pleased to hear what was said because that's a part of the equation that gets overlooked.

KRT

New Mexico Governor Bill Richardson called a special session of the legislature to consider tax reform but was strongly opposed to a proposed gas tax increase.

"You can't get total tax reform in a three or four-month period," commented Hobbs, noting the blue-ribbon commission met only part-time from June through September. "No reform came out of the commission."

M. Gene Aldridge, president of the New Mexico Independence Research Institute, agreed.

"The difficulty with most ... tax reform is that it is piecemeal and patchwork at best. It does not adjust the taxation policies to a good plan for economic development. The recent Blue Ribbon Committee on taxes once again did not solve problems—it just looped in small adjustments and in most cases proposed raising taxes.

"Good economic development policy means finding ways to cut government spending so that the taxes are not needed in the first place," said Aldridge. "Limited government must be the guiding principle."

John Skorburg is managing editor of Budget & Tax News. *His email address is* **skorburg@heartland.org**.

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Maine Voters Can't Agree on Economy-Busting School Funding Plans

by Diane Carol Bast

Maine voters went to the polls on November 4 for a Referendum Election that presented six questions addressing everything from horse racing and casinos to bond issues for higher education and highways.

Top among the ballot measures was Question 1—actually three competing questions—addressing education funding. None of the three questions attracted support from a majority of voters, meaning the top vote-getter will go before voters again in 2004.

Question 1A, a citizen's initiative placed on the ballot by the Maine Municipal Association (MMA), attracted 38 percent of the vote—more than the 35 percent received by 1B, a competing plan submitted by the governor and legislature, and the 27 percent received by 1C, a "none of the above" option.

The MMA initiative would require the state to "immediately" fund 55 percent of the government's total spending on K-12 education, as well as 100 percent of all prior year "unreimbursed special education expenditures."

"None of the three questions attracted support from a majority of voters, meaning the top vote-getter will go before voters again in 2004."

Economic Impact Tested

Two weeks before the Maine vote, the Maine Public Policy Institute (MPPI), a nonpartisan research organization headquartered in Bangor, released an analysis of the likely impact of Question 1A and 1B on the Pine Tree State's economy.

The report, *Truth and Consequences: The Impact of Tax Reform on Jobs and Investments*, was written for MPPI by economists with the Boston-based Beacon Hill Institute (BHI) at Suffolk University, including David G. Tuerck, Ph.D., president of Beacon Hill. The report was issued jointly by MPPI and Beacon Hill. Its projections were developed by employing the Maine State Tax Analysis Modeling Program (STAMP), a comprehensive model of the Maine economy designed to capture the principal effects of tax changes on that economy.

"The Maine Municipal Association's (MMA) Question 1A and the Governor's Question 1B would, at best, shift taxes—lowering the property tax while raising an equal amount with either the sales or income taxes. But at what cost?" asked Scott K. Fish, director of special projects for MPPI. "Now, we can answer that question."

To meet the 55 percent education funding requirement mandated by Questions 1A and 1B, the *Truth and Consequences* report notes, would require an estimated $250 million in new state revenue in the first year of the mandate alone. The report assumes the $250 million would come from some combination of three actions:

- Cutting state spending
- Broadening the sales tax base, or
- Increasing the state income tax.

Competing Questions

Maine Municipal Association's Citizen Initiative (1A)
The MMA Citizen's Initiative requires the state to immediately fund 55% of the total K-12 education allocation. By June 30, 2004, the Legislature would be required to have a funding plan in place that would include defining the total allocation and then the revenue source(s), to achieve the 55% state share for the FY 2004-05 school year. The Citizen's Initiative also requires the state to immediately fund 100% of all prior year unreimbursed special education expenditures.
Do you support Citizens Initiative 1A?

Final Vote
1A - 38 percent
1B - 35 percent
1C - 27 percent

The Governor and Legislature's Competing Tax Relief Measure (1B)
The Competing Measure strengthens the Essential Programs and Services (EPS) model of school funding (LD1623), enacted by the 121st legislature, by providing the increased state support over the specified five-year period necessary to achieve the goal of 55% state share of statewide K-12 education costs by FY 2009-10.
Do you support the Governor's and Legislature's Competing Tax Relieve Measure 1B?

Do you support 1C — None of the Above?

Sales Tax Funding

"Nothing in recent Maine history shows a $250 million state spending cut as a real option," said Fish. "However, history does show the MMA pushing an expansion of the state sales tax as a way to raise an extra $250 million. So we tested the impact of a $250 million broadening of the sales tax, coupled with a 15 percent reduction in local property tax rates across Maine."

According to the report, removing just 20 percent of Maine's current sales tax exemptions would raise an additional $250 million in state revenues. But doing so would also mean:

- the loss of more than 2,500 jobs
- a $75 million drop in real disposable income, and
- a $27 drop in per-capita real disposable income.

Income Tax Funding

Fish said, "We thought this news might cause 1A and 1B proponents to think about raising the state income tax instead of the sales tax. So we tested the impact of that option as well."

To raise $250 million in new revenues would require raising the state's income tax rates by 20 percent. The net effect of that increase, with a 15 percent reduction in local property tax rates, is $251 million in new state revenue ... and:

- the loss of more than 9,800 jobs
- a population loss of 5,600 Maine families, as those who have lost their jobs seek better options elsewhere, and
- a $92 million drop in real disposable income.

As Maine prepares for the 2004 vote on Question 1A, Fish encouraged voters to pay careful attention to the *Truth and Consequences* report and the overall impact the measure would have on their well-being. The measure's proponents "are pushing for tax changes and not telling Mainers how many jobs will be lost or what will happen to their disposable income if it passes," Fish said.

"This new economic modeling program will not let them hide that side of the ledger any longer," he continued. "Whether it is a personal income tax change, a sales tax change, a gas tax change, or any other state tax change, Maine-STAMP will show policymakers and taxpayers the full impact of such changes on Maine families and job creators."

Diane Carol Bast is vice president of The Heartland Institute and editor of Budget & Tax News. *Her email address is* **dbast@heartland.org**.

INTERNET INFO

Truth and Consequences: The Impact of Tax Reform on Jobs and Investments can be downloaded in Adobe Acrobat's PDF format from the Web site of the Maine Public Policy Institute at **http://www.maineinstitute.com/maine_stamp.pdf**.

Further information about the work and mission of MPPI is available at **http://www.maineinstitute.com**.

Further information about the Beacon Hill Institute is available at **http://www.beaconhill.org**.

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"No Tax" Pledge Signers Win in Mississippi and Kentucky

by John Skorburg

Mississippi taxpayers celebrated in early November at the election of Republican Haley Barbour as the state's next governor. During his campaign, Barbour, a former chairman of the Republican National Committee, signed the Taxpayer Protection Pledge, sponsored by Americans for Tax Reform (ATR).

The pledge commits a public official to "oppose and veto any and all efforts to increase taxes." ATR said Barbour's opponent, incumbent Ronnie Musgrove (D), refused to sign the pledge.

"Haley Barbour's signature on the Taxpayer Protection Pledge shows to the voters of Mississippi that he is committed to Mississippi's hard-working families," said taxpayer advocate Grover Norquist, president of ATR. "He knows the people have to live within their budgets, and government should do the same. The last thing Mississippians need is to have Jackson take more of their paychecks to fund more spending."

Two states to the north, Kentucky also elected a Republican governor on November 4—for the first time since 1967—choosing Congressman Ernie Fletcher, who pledged to "clean up state government and balance the state budget without raising taxes or cutting services."

Fletcher defeated Attorney General Ben Chandler, carrying every part of the state except for the Democratic strongholds of Louisville and Eastern Kentucky.

Fletcher and Barbour won their races by 55-45 and 53-45 percent margins, respectively.

"The 2003 elections were elections overwhelmingly dominated by the tax issue, and taxpayers all across the country can breathe a little easier," said Norquist. "The sentiment that 'enough is enough' where taxes are concerned has taken a firm hold at both the state and federal levels."

President George W. Bush, 42 U.S. Senators, 217 Congressmen, 10 governors (including Barbour and Fletcher), and more than 1,200 state legislators have signed ATR's pledge.

"The 2003 elections were elections overwhelmingly dominated by the tax issue, and taxpayers all across the country can breathe a little easier. The sentiment that 'enough is enough' where taxes are concerned has taken a firm hold at both the state and federal levels."

GROVER NORQUIST, PRESIDENT
AMERICANS FOR TAX REFORM

"Yet again, the tax issue can turn an election," said Norquist. "We already saw it in the humiliation of Bob Riley (R) in Alabama in September, and the rejection of Gray Davis for Arnold Schwarzenegger in October. Neither Riley or Davis are pledge signers. Now Haley Barbour and Ernie Fletcher are continuing the signer trend. Perhaps the message has finally reached state houses that a governor cannot raise taxes and have any political future."

Ernie Fletcher

Haley Barbour

John Skorburg is managing editor of Budget & Tax News. *His email address is* **skorburg@heartland.org**.

Taxpayer Protection Pledge

I, _____,

pledge to the taxpayers of the _____ district

of the State of _____ and to all the people of this state,

that I will oppose and vote against any

and all efforts to increase taxes.

_____ _____

Signed (candidate) Date

_____ _____

Witness Witness

To see a list of "pledge signers" in your state, go to **http://www.atr.org/ads2003.html**.

Americans for Tax Reform | 1920 L Street NW | Suite 200 | Washington, DC 20036

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Philadelphia Weighs Property Tax Reform

by Chuck Metalitz

Pennsylvania was the birthplace of one of the most novel approaches to property taxation: the "two-rate," or land value tax (LVT), developed by Philadelphia-born philosopher and economist Henry George (1839-1897).

Today, 18 cities, one school district, and one special district in Pennsylvania tax land at a higher rate than buildings. The results have been the subject of national attention by state and local policymakers searching for pro-economic growth tax policies.

TABLE 1
CONVENTIONAL REAL ESTATE TAX
Amount Paid by Two Hypothetical Adjacent Parcels

Parcel	Vacant Lot	Lot with House
Value of Land	$50,000	$50,000
Tax on Land @ 1%	$500	$500
Value of Improvement	-0-	$75,000
Tax on Improvement @ 1%	-0-	$750
Total Tax	$500	$1,250

TABLE 2
LAND VALUE TAX
Amount Paid by Two Hypothetical Adjacent Parcels

Parcel	Vacant Lot	Lot with House
Value of Land	$50,000	$50,000
Tax on Land @ 1.75%	$875	$875
Value of Improvement	-0-	$75,000
No Tax on Improvement	-0-	-0-
Total Tax	$875	$875

Learning More about Land Value Taxation

Efforts to encourage land value taxation (LVT) are part of a larger movement based on the ideas of American philosopher and economist Henry George (1839-1897). One of the most famous Americans of his time, George outlined in his 1883 work, *Social Problems*, the following principles: "He who makes should have; he who saves should enjoy; what the community produces belongs to the community for communal uses; and God's Earth, all of it, is the right of the people who inhabit the Earth."

Many organizations across the country work to attract attention to George's ideas today. There are Henry George Schools in New York, Chicago, Philadelphia, California, Massachusetts, Oregon, Nicaragua, Canada, and the Dominican Republic; research organizations in the U.S. and abroad; and advocacy groups, including Common Ground-USA and the International Georgist Union.

Readers wishing to learn more about LVT can contact the Center for the Study of Economics (**http://www.urbantools.net**), 1422 Chestnut Street #414, Philadelphia, PA 19102; phone 215/988-9998. Those interested in a comprehensive exploration of George's philosophy should contact one of the Henry George Schools—the Chicago school's Web site at **http://www.hgchicago.org** offers links to the other schools. Correspondence and email courses also are available through the Henry George Institute, **http://www.henrygeorge.org**.

— C.M.

Debate in Philadelphia

The two-rate system is getting serious consideration in Philadelphia, where it has been endorsed by the Tax Reform Commission and championed by City Controller Jonathan A. Saidel. Philadelphia Councilwoman Jan Blackwell has introduced a resolution calling on the Council Committee of the Whole to hold hearings on Saidel's proposal.

"Land-Value Taxation would reward owners who strengthen neighborhoods while it would punish those who are causing blight across the city," Saidel said earlier this year when he released the findings of a Drexel University study on land value taxation.

The report, prepared by Roger McCain, Paul Jensen, and Stephen Meyer of the department of economics and international business in the university's LeBow College of Business Administration, concluded a revenue-neutral shift to an LVT system would lower property taxes for four of every five residential properties in Philadelphia.

Saidel has been championing such a system since November 2001, when his office issued a 98-page *Tax Structure Analysis Report* that recommended the city change the way it taxes real estate. At present, a tax on land generates roughly 22.5 percent of the city's real estate tax revenues, while a tax on structures and improvements generates roughly 77.5 percent. Saidel proposes switching to a system where the two taxes each generate an equal amount of revenue.

"By reducing the tax on structures and increasing the tax on land, we can encourage property owners to best utilize their properties, discourage speculators from holding land vacant and allowing buildings to decay, and encourage economic development across the city."

JONATHAN A. SAIDEL
PHILADELPHIA CITY CONTROLLER

"By reducing the tax on structures and increasing the tax on land," Saidel explained, "we can encourage property owners to best utilize their properties, discourage speculators from holding land vacant and allowing buildings to decay, and encourage economic development across the city."

How Land Value Taxes Work

The real estate tax is a combination of two taxes: one on the land itself, and one on improvements made to the land, generally buildings or other structures. By changing how the two taxes are applied, Saidel points out, "we can change how property owners act."

Consider two adjacent properties of equal value, one vacant and the other with a house. Under a conventional real estate tax, the two properties might generate $1,750 in total tax revenues, and the property owners' tax bills might look like Table 1.

The conventional real estate tax penalizes investment—all other things being equal, it's less expensive to leave a property vacant than it is to improve it.

The conventional real estate tax also raises the cost of housing. Putting a house on the lot has cost the owner $750 a year in real estate tax, or $62.50/month. If the building is a rental property, its owner must charge higher rent in order to recoup the tax cost.

The incentives are different under a land value tax system. Although an LVT can be implemented many different ways, for the sake of simplicity consider a system that taxes the value of land but does not tax the value of

Continued on 15

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Philadelphia Councilwoman Jan Blackwell

Philadelphia Controller Jonathan A. Saidel

Philadelphia continued

improvements.

Table 2 shows how raising the tax on land and eliminating it on improvements can generate the same amount of revenue as the conventional real estate tax system described in Table 1.

Under an LVT system, homeowners pay less and the owners of vacant lots pay more. But the latter benefit too: They can build on their lots without paying any additional tax. Theoretically, that reduces the cost of a $75,000 house by $62.50/month.

"The conventional real estate tax penalizes investment—all other things being equal, it's less expensive to leave a property vacant than it is to improve it."

More Housing, More Jobs

Giving property owners an incentive to improve their properties creates more housing, and that housing is less expensive. The construction activity also creates jobs.

Economist Florenz Plassmann, currently with State University of New York at Binghamton, has conducted mathematically sophisticated studies comparing Pennsylvania's two-rate cities to cities using conventional one-rate. He concludes that, in cities where additional development "was considered a good thing," the two-rate tax system has resulted in increased construction of housing as well as nonresidential buildings. Tabulations by the Center for the Study of Economics have consistently supported that finding. This work implies more jobs and less-expensive housing, but studies directly addressing that relationship apparently have yet to be done.

Harrisburg, one of the Pennsylvania cities that has adopted land value taxes, has seen major improvements in its economy and quality of life. "Without hesitation we can commend the importance and benefit of the land-value tax policy," says Mayor Stephen R. Reed.

Legal Issues

Rules governing the assessment and taxation of real property vary from state to state. According to a 1999 article published in the *George Mason Law Review* by Anthony Coughlan, most states require "uniformity" in assessment, but at least 20 allow some "classification" of real property, which could permit LVT.

In Illinois, for example, counties with populations of more than 200,000 are permitted to classify real property for taxation purposes. The most heavily taxed property class may not pay a rate more than 2.5 times the rate applied to the class taxed most lightly.

In states that do not explicitly permit classification, according to Coughlan, a review of case law would be required to determine the legality of LVT.

Chuck Metalitz is director of the Henry George School in Chicago. His email address is **taxpayer@pobox.com**

INTERNET INFO

The March 2003 Drexel University report, *Research on Valuation of Land and Improvements in Philadelphia*, is available in Adobe Acrobat's PDF format from The Heartland Institute's free *PolicyBot* research database. Point your Web browser to **http://www.heartland.org**, click on the *PolicyBot* button, and search for document **#13672**.

Philadelphia Controller Jonathan Saidel's November 2001 report, *Tax Structure Analysis Report*, is also available through *PolicyBot*. Search for document **#13671**.

Florenz Plassmann's study *The Impact of Two-Rate Taxes on Construction in Pennsylvania* is posted at **http://scholar.lib.vt.edu/theses/available/etd-61097-13834/**

Additional studies and information regarding two-rate in Pennsylvania and elsewhere is at the Center for the Study of Economics site, **http://www.urbantools.net**.

County Officials, Business Leaders Oppose Cook County Tax Plan

by John Skorburg

A tax increase proposal floated in late October by John Stroger, president of the Cook County, Illinois, Board of Commissioners, attracted the ire of the Chicago business community and suspicion from the county commissioners who serve under him.

John Stroger

In a $3 billion annual budget, Stroger predicts a $100 million shortfall for fiscal year 2004, which began December 1. To plug the gap, Stroger called for increasing the county sales tax from .75 percent to 1.0 percent. The rate has been at .75 percent since 1991.

The increase would give Chicago, the county seat, a sales tax rate of 9.0 percent. Only two other cities in the nation—Nashville and New Orleans—have sales taxes that high.

"Difficult times require difficult decisions," said Stroger.

Stroger boasted his 2004 budget proposal holds the line on property taxes for the fifth consecutive year. He predicted the sales tax increase, when fully implemented, would net about $70 million for the county; a proposed 4 percent lease tax on automobiles and computer equipment would yield about $58 million, nearly enough to close the projected 2004 budget gap.

Public hearings on the Stroger proposal were held in November. Final approval of the 2004 budget was expected in late November, after this newspaper went to press.

Adverse Reaction

Gerald Roper, CEO of the Chicagoland Chamber of Commerce, warned Stroger's tax increases would have negative consequences for the area's business climate. "This is a massive advertising campaign for Indiana and Wisconsin," Roper said. "All he could do is possibly push companies, push consumers, push visitors out of this area."

The Illinois Retail Merchant's Association (IRMA) also reacted against the plan. Noted IRMA President David Vite, "Without a healthy retail sector in Illinois that encourages continued investment in personnel, advertising, buildings, and merchandise, sales tax revenue would not continue to rise and state and local government budgets would be severely and negatively impacted."

The business community has allies on the county board.

"Cook County government has raised taxes on people in this county by $500 million in the last decade," said Commissioner Forrest Claypool (D-Chicago).

"That's not a way to run a business," said suburban commissioner Carl Hansen, a Republican from Mt. Prospect. He noted several other suburban commissioners have shared with him their doubts about Stroger's proposal. That opposition, Hansen said, "is kind of refreshing, since I've been the only one voting 'no' on [similar tax increases] all these years."

Cut Spending Instead?

Commissioner Michael Quigley, another Chicago Democrat, offered a plan to cut spending by up to $50 million by consolidating county offices that offer duplicative services and shifting many of the county sheriff's responsibilities to individual suburbs.

"No one likes to lose their power and prestige and so forth," acknowledged Quigley, "but every hundred years, a city and a county ought to win a world series, and they ought to restructure their government to bring it in line with reality of the modern world."

"The Cook County government is legendary for its waste and bloat. It's a place where every politician's relative can find a home, and more taxes is not the answer. The answer is to cut spending."

FORREST CLAYPOOL (D-CHICAGO)
COOK COUNTY COMMISSIONER

Suburban Commissioner Larry Seffredin, a Democrat from Evanston, will vote no on Stroger's proposal. "Now more than ever," Seffredin said, "the County must tighten its belt at all levels and look for innovative ways to maintain and improve services. I vehemently oppose the two tax increases ... proposed by President Stroger."

Stroger says he is already cutting so many jobs and so much waste there is nowhere else to turn without decimating the health, law enforcement, and criminal justice services county residents expect and demand.

Claypool disagreed. "The Cook County government is legendary for its waste and bloat," he said. "It's a place where every politician's relative can find a home, and more taxes is not the answer. The answer is to cut spending."

John Skorburg is managing editor of Budget & Tax News. *His email address is* **skorburg@heartland.org**.

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Massachusetts

Continued from page 1

at Suffolk University, Romney deserves a solid B+ for his recent performance.

"Considering what he was up against, he did a pretty good job," says David G. Tuerck, executive director of the Beacon Hill Institute and chairman of the economics department at Suffolk University. "Judging from our criteria, Governor Romney understands the principles of good budgeting."

The institute graded Romney this fall according to five principles of effective budgeting: neutrality, equity, efficiency, responsibility, and limiting government. The governor has kept most of the promises on which he campaigned last year.

"The institute graded Romney this fall according to five principles of effective budgeting: neutrality, equity, efficiency, responsibility, and limiting government."

The Romney Report Card

A–	Neutrality	Avoiding taxes and expenditures that distort private choices and discourage economic activity.
A	Equity	Achieving fairness in taxes and expenditures; secure the social safety net.
B+	Efficiency	Keeping the cost of government low; constraining unit costs.
A	Responsibility	Balancing the budget.
C	Limiting Government	Achieving the proper balance between the needs of the public sector and those of the private sector.

Source: Beacon Hill Institute, 2003

Romney met the test of responsibility by using his veto pen to make certain the Commonwealth's spending would not exceed revenues. With regard to efficiency, his efforts to close the FY 2004 budget gap met with some success, although he failed to convince the legislature to accept his consolidation of the Massachusetts Turnpike Authority and Highway Department.

Failing to Limit Government

The Commonwealth's FY 2003 budget ended with a small surplus, and the FY 2004 budget will be balanced at $23 billion. Nevertheless, Beacon Hill faulted Romney for his failure to achieve the right balance between the needs of government and those of taxpayers and businesses. According to the Beacon Hill analysts, voters want a government that takes a smaller share of the economic pie.

The opponents of limited government assert the Commonwealth's share of the economy cannot be made smaller, because current services must be maintained, and unless enough revenues are brought in to cover those services the budget cannot help but be in deficit. Romney appears to have bought into this notion of a "structural deficit."

Implicit in the "structural deficit" notion is the assumption that government is powerless to reduce the cost of providing services, and therefore the only remaining recourse is to raise taxes. That assumption, according to Beacon Hill, is clearly flawed.

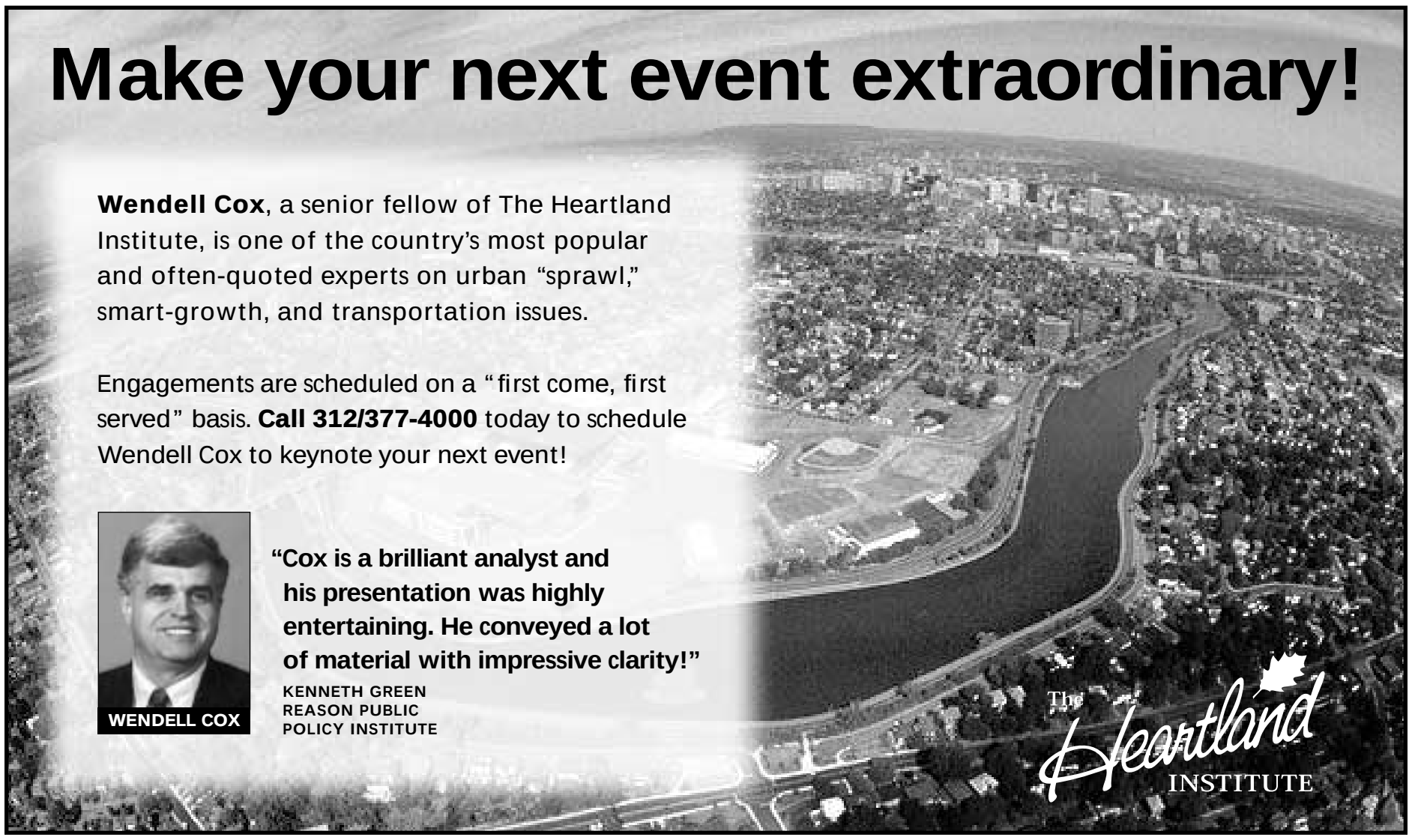
"Unlike a consumer who walks into a grocery store with less money to spend, government has a lot of control over what it pays for things," notes Tuerck. "If government has the capacity to get what it buys at lower prices, then it does not have to shrink the services it delivers even if the amount of money it brings in temporarily levels off or falls.

"We can't fault the governor for having a legislature that makes such reforms a daunting challenge," says Tuerck. "But we can fault him for buying into the idea of a structural deficit that makes it impossible for him to make any meaningful dent in the size of government."

Frank Conte is director of communications and information services for the Beacon Hill Institute. His email address is **bhi@beaconhill.org**.

INTERNET INFO

The Beacon Hill Institute's report card on Governor Mitt Romney can be found on the BHI Web site at **http://www.beaconhill.org/faxsheets/Director5772003.pdf**.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Senator Ron Wyden (D-Oregon)

Internet

Continued from page 1

returns in January or when states return to session.

Senator Ron Wyden (D-Oregon), one of the principal proponents of the moratorium, has accused some state and local officials of trying to change the definition of "Internet access" in order to find new ways to tax.

"In doing so, what it would do is give states and localities explicit permission to tax what Internet users do once they get on line," Wyden said in an October 15 floor speech. "That would mean you could have games, music, magazines, newspapers, information services, financial services, research services, or other products or services, in effect, facing a barrage of new taxes," Wyden warned.

"The phrase 'you've got mail' would be replaced with 'you owe taxes,'" he quipped.

Senators Lamar Alexander (R-Tennessee) and Maria Cantwell (D-Washington), among others, have placed a procedural "hold" on the Senate bill amid concerns over state budget deficits.

Alexander called a no-tax plan sponsored by Wyden and Allen the "worst kind of unfunded mandate."

"If you limit Tennessee's ability to have a broad-based sales tax, then you are increasing the chances Tennessee has an income tax or a higher tax on medicine or food. Or higher college tuition for families to pay," Alexander explained.

Taxpayer groups, including Americans for Tax Reform, are fighting for the moratorium to be continued. ATR President Grover Norquist said Internet taxes would hurt consumers. He contends backers of the hold are "supporting taxes on Internet access and e-mail, as well as double-taxation of a product or service bought over the Internet."

Senator George Voinovich (R-Ohio) is insisting on changes to the moratorium. His home state stands to lose existing tax revenue from phone taxes, Voinovich believes, unless the bill's language is clarified. The problem stems from an overly broad definition of telecommunications services that could encompass future Internet-based telephone services, he fears.

Ohio Governor Bob Taft, a fellow Republican, wrote Voinovich a letter estimating that extending the moratorium would cost the state $350 million, but such cost estimates vary. Nationwide, the Congressional Budget Office has estimated extending and expanding the moratorium would deprive states of $80 to $120 million in taxes annually. But the Multistate Tax Commission has said states are likely to forego between $4 billion and $9 billion in 2006 alone.

John Berthoud of the National Taxpayers Union (NTU) says it's just politicians looking to tax their way out of a problem. "The bottom line is that these guys just want more money," Berthoud said.

"Congress shouldn't allow new Internet access taxes or multiple-state taxation of a single item purchased online, [NTU's Paul] Gessing believes, because 'it amounts to double jeopardy.'"

"Internet use is already taxed through the burdens that states and localities impose on phone and cable bills," added NTU's Paul Gessing. Congress shouldn't allow new Internet access taxes or multiple-state taxation of a single item purchased online, Gessing believes, because "it amounts to double jeopardy."

Another obstacle to be overcome is the differences in state and local taxation—there are almost 8,000 different tax-collecting jurisdictions in the United States.

As *U.S. News* reported: "Cough drops, for example, are taxable in Massachusetts but not in Maryland, while in Ohio a gift basket of fruit is not taxed though a crystal dish filled with candy is. Cloth diapers in Wisconsin? Tax exempt. Disposable ones? Taxable."

States are promising more uniformity of product definitions and taxable vs. non-taxable items, and special software is becoming available that will instantly calculate taxes based on the zip code of the buyer.

Says Patti Freeman Evans of Jupiter Research, "Consumers are used to paying tax." Albeit not on the Internet.

Christine Hall comes to CNSNews.com from Capitol Hill, having served as Rep. Mark Sanford's Social Security policy analyst. Prior to that, she worked as a policy analyst on Steve Forbes's Presidential campaign and also served as director of public affairs for the Seniors Coalition. CSNNews can be found on the web at **http://www.CNSNews.com**.

IRS to Step Up Audits and Collections

by Daniel J. Pilla

For more than two years, Congress has been asking the Internal Revenue Service to take off the gloves. "Go get the money," is the clarion call from Washington. There can be little doubt Mark Everson got the nod as the country's new IRS commissioner because he can and is willing to lead this charge. And if Bush has his way, Everson will get the tools he needs to do it.

New Commissioner

Everson is the 46th person to hold that post since the agency was created in 1862. He was appointed in early 2003 by President George W. Bush to assume the position vacated by Charles Rossotti, who stepped down in November 2002. The U.S. Senate confirmed Everson in May.

Everson previously served in the Bush administration at the Office of Management and Budget. He also headed the President's Management Council, a team charged with implementing Bush's management initiatives. Everson has private-sector experience in upper management positions in both service and manufacturing companies. From a management standpoint, he seems well-suited for his new job.

The new commissioner has pledged more audits and collection actions. If things go as the President wishes (and it seems they will), Congress will hand the IRS even more money for fiscal 2004 to carry out those tasks. The administration's budget proposal for the IRS calls for total spending of $10.437 billion, up nearly 6 percent from last year, with an accompanying increase of 888 full-time staff positions, an increase of 1 percent over last year.

Everson has said, "The IRS must deter those who might be inclined to evade their legal tax obligations, and appropriately pursue those who actually do so." Every commissioner since the beginning of time has mouthed these sentiments, especially to Congress during his confirmation hearing. But the comment has much more significance today, when the United States is staring huge deficits in the face and against the backdrop of reports that millions of people have delinquent tax debts they won't (or more likely, can't) pay.

Of the proposed IRS budget of $10 billion, specific funding initiatives include:

- $4 billion for "tax law enforcement"
- $1.7 billion for computer upgrades
- $500 million for business systems modernization
- $2 million to use private-sector debt collectors in delinquency cases.

The administration's request for $4 billion for "tax law enforcement" includes money to increase audits (upwards of 72 percent in some cases), expand the document matching programs, collect delinquent tax debts, and conduct criminal investigations and prosecutions.

Under this large umbrella of spending will be a $133 million initiative to fund new programs to target both individuals and businesses. Among other things, the IRS will focus on:

- abusive tax schemes such as shelters, trusts, and offshore accounts,
- underreporting of income and tax return non-filing,
- failure of employers to report wage income or pay employment taxes, and
- stiffer enforcement of the Earned Income Tax Credit program.

Everson's remarks also indicate that under his direction, the IRS may point its enforcement guns at tax professionals. "There are clear indications that professional standards have eroded in some corners of the practitioner community," Everson noted. "Attorneys and accountants should be pillars of our system of taxation, not the architects of its circumvention."

This may be troublesome, since the first responsibility that attorneys and accountants have is to their clients. Now, that's certainly not to say tax professionals should suborn evasion, perjury, or any other unlawful act. They should not, and, in fact, there are already laws against that. But it is also not true that they should hold an unthinking allegiance to the system such that the client's best legal interests are subjugated.

This is essentially what the IRS did with the tax preparation community nearly two decades ago. By adding a wide assortment of so-called "preparer penalties" to the tax code, the IRS cleaved the interests of the return preparer from those of the client. As a result, when a tax return comes under audit, the preparer thinks of covering his own hide first and often forgets about the client. The preparer penalties have effectively made too many tax preparers into tax *collectors*, paid by the private sector.

If the IRS does point its enforcement guns at tax pros, beginning a program of systematic harassment—audits, intimidation, investigations, prosecutions—against tax attorneys and CPAs, this will have a tremendously chilling effect on the independence of the profession. With enough muscle, the IRS can bring under its thumb an entire service industry that heretofore has functioned solely to assist honest citizens in navigating the labyrinth of laws we call the tax code.

Dan Pilla is a tax litigation consultant and author of 11 books on taxpayers' rights and IRS defense strategies. Harper Collins will release his latest book, titled The IRS Problem Solver: From Assessments to Audits—How to Solve Your Tax Problems and Keep the IRS Off Your Back—*in December 2003. His newsletter,* Dan Pilla's Confidential Tax Bulletin, *is available by calling 800/346-6829, or online at* **http://www.taxhelponline.com**.

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Indian

Continued from page 1

plexity and importance of this issue, the Department will use this additional time to continue to receive public comments and to evaluate and study this matter," stated a department news release issued November 3.

The department's decision evoked frustration among New York state retailers hoping for a "level playing field." As Jim Calvin, president of the New York Association of Convenience Stores, explained in a November 10 statement, "The last mile of the long, hard journey toward a level playing field is being obstructed by clouds of propaganda and unwarranted delay. But we are determined not to let misinformation poison public opinion or shake the resolve of the courageous legislators who share our thirst for tax fairness."

New York smokers, however, appear to support the Indian tribes on this one. New York City C.L.A.S.H. (Citizens Lobbying Against Smoker Harassment) urged its Web site viewers to oppose the measure.

"[The Indians] have embarked on an ad campaign informing state residents that the NYS government is breaking a centuries' old treaty," its Action Alert #2 reads. "They're asking you to get involved and you should—for ALL of our sakes. Besides it just not being right, ... you'll find yourself paying the taxes on your cigarettes no matter where you get them from in New York."

KRT

Ronald Bell Jr. sells tax-free cigarettes from an Indian reservation in eastern Long Island, New York.

Addressing a Budget Deficit

In December 1999, the New York state legislature nearly doubled the excise tax on a carton of cigarettes from $5.60 to $11.10—the second highest state cigarette tax in the country. According to Calvin's group, taxable cigarette sales across New York dropped by 51.8 million cartons in the 24 months following the March 2000 implementation of that tax increase.

The FACT Alliance for the Fair Application of Cigarette Taxes, of which Calvin's group is a founding member, has estimated New York state government lost $1.5 billion in 2001 and 2002 by failing to collect taxes on Indian cigarette sales to non-Indian customers. Establishing parity between Indian and non-Indian tobacco sales is thus part of New York's 2003 state budget plan. The state faces an $11.5 billion budget deficit, which it hopes to help address with additional tobacco tax monies.

Wholesalers would be required to pay the excise tax—including a 39 cent per pack federal excise tax—on every carton of cigarettes they sell to retailers on Native American territories.

The FACT Alliance represents groups that ordinarily would oppose tobacco tax increases, among them Calvin's Association of Convenience Stores, the Food Industry Alliance of New York State, Gasoline and Repair Shop Association of New York, New York State Association of Wholesale Marketers & Distributors, and Independent Petroleum Marketers of New York.

Having lost their battle to fend off the 1999 cigarette tax hike, the groups now hope to win a level playing field. "We're tired of shouldering the negative effects every day," said Calvin. "Tired of rampant, state-sanctioned tax evasion eroding our customer base, diminishing our bottom line, sapping our ability to provide employment, to serve our patrons, to invest capital, to support our communities."

Native Americans Respond

Tribal leaders say paying the tax would weaken their claims of sovereignty and cause a loss of jobs on their reservations. "None of the state's Indian nations are willing to pay (cigarette) taxes to New York, not even if the tax is paid indirectly through a wholesaler," Onondaga Nation Chief Irving Powless said.

"By creating its own tobacco-wholesaling business, the Seneca Nation believes it would not be required to collect the new tax, allowing it to keep cigarettes prices low at reservation stores."

Leaders of the Seneca Indian Nation in upstate New York are contemplating the launch of a wholesale tobacco business, the *Buffalo News* reported on October 25, in order to avoid paying state taxes on tobacco products. The Seneca Nation is one of the six tribes of the Iroquois Confederacy who occupy aboriginal lands in New York State set aside in 1794. The Seneca Nation has a total population of more than 7,200 and holds title to three reservations in New York.

By creating its own tobacco-wholesaling business, the Seneca Nation believes it would not be required to collect the new tax, allowing it to keep cigarettes prices low and sales high at reservation stores. According to Seneca leaders, the state would be "unable to enforce the new regulation on cigarettes coming from their (own) wholesale company to Seneca retailers."

According to news reports, one option being explored by Seneca leaders is the purchase of the tobacco wholesale company A.D. Bedell. Bedell is a licensed cigarette stamping agent, responsible for placing excise tax stamps on all cigarettes except those destined for Indian reservations, where they are currently tax-exempt. The company is currently in litigation in New York and Michigan over illegal business practices.

State officials are meeting with tribal leaders, who remain gravely concerned about the job losses that would result from taxing their currently tax-free tobacco sales. "We are confident that once New Yorkers know the facts they will support our position and will take action with their leaders," Seneca Nation President Rickey Armstrong Sr. said in late October.

At risk, the nation said, are 1,000 Seneca and non-Seneca jobs, as well as the nation's right to operate free of interference from state government. The Seneca Nation is the primary employer of Indians on the reservations. The Nation operates the Seneca Niagara Casino in Niagara Falls, New York, as well as "Seneca One Stop" convenience stores on each of the three reservations, Seneca Bingo Halls, and the Highbanks Campgrounds. Tax-free cigarette sales are a significant attraction for many patrons of the Seneca Nation's business enterprises.

The FACT Alliance contends the job-loss argument is a red herring, noting in a fact sheet that "Any increase in employment experienced by tribal stores in recent years was actually a job *shift* from licensed, tax-collecting non-tribal retail stores to tax-free tribal stores fueled by a huge shift in purchasing habits by non-New York smokers seeking to avoid paying taxes.

"The retail jobs are going to exist somewhere," continues the fact sheet. "The question for New Yorkers is, do you want those jobs to be on the licensed, regulated, tax-generating side of the street?"

Diane Carol Bast is vice president of The Heartland Institute. Her email address is **dbast@heartland.org**.

INTERNET INFO

For more information from a smoker's perspective, visit the Web site of New York City C.L.A.S.H. at **http://www.nycclash.com/**; The Smoker's Club at **http://www.smokersclub.com/**; and The Heartland Institute's Smoker's Lounge at **http://www.heartland.org/IssueSuites.cfm?issId=4**.

...from the retailer's perspective, visit the Web site of the New York Association of Convenience Stores at **http://www.nyacs.org/**; and the FACT Alliance at **http://www.factalliance.org/taxstudy.html.**

...from the perspective of Native Americans, visit the Web site of the Seneca Nation of Indians at **http://www.sni.org/news.html**.

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States Ranked by Cigarette Tax

Washington state increased its cigarette tax to $1.425 a pack on January 1, 2003, making it the nation's highest. Additional taxes on cigarettes include the federal excise tax (39 cents a pack) and state and local sales taxes. The states and the District of Columbia are ranked in the table below by state tax alone. (Note: New York City has the highest local excise tax at $1.50 per pack.)

Rank	State	Tax
1.	Washington	$1.425
2.	New York	$1.11
3.	Alaska	$1.00
3.	Hawaii	$1.00
3.	Maine	$1.00
3.	Rhode Island	$1.00
7.	California	$0.87
8.	New Jersey	$0.80
9.	Wisconsin	$0.77
10.	Massachusetts	$0.76
11.	Michigan	$0.75
12.	Oregon	$0.68
13.	Maryland	$0.66
14.	D.C.	$0.65
15.	Arizona	$0.58
15.	Illinois	$0.58
17.	New Hampshire	$0.52
18.	Utah	$0.515
19.	Connecticut	$0.50
20.	Minnesota	$0.48
21.	North Dakota	$0.44
21.	Vermont	$0.44
22.	Texas	$0.41
24.	Iowa	$0.36
25.	Nevada	$0.35
26.	Nebraska	$0.34
27.	Florida	$0.339
28.	South Dakota	$0.33
29.	Arkansas	$0.315
30.	Pennsylvania	$0.31
31.	Idaho	$0.28
32.	Delaware	$0.24
32.	Kansas	$0.24
32.	Louisiana	$0.24
32.	Ohio	$0.24
36.	Oklahoma	$0.23
37.	New Mexico	$0.21
38.	Colorado	$0.20
39.	Mississippi	$0.18
39.	Montana	$0.18
41.	Missouri	$0.17
41.	Alabama	$0.17
41.	West Virginia	$0.17
44.	Indiana	$0.155
45.	Tennessee	$0.13
46.	Georgia	$0.12
46.	Wyoming	$0.12
48.	South Carolina	$0.07
49.	North Carolina	$0.05
50.	Kentucky	$0.03
51.	Virginia	$0.025

Source: Commerce Clearing House

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